

# Summary of the Small Business Health Insurance Tax Credit Under ACA

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This report provides a brief description of the small business health insurance tax credit as established under the Affordable Care Act (ACA, P.L. 111-148, as amended). The tax credit is one of several provisions in ACA directed at the small group health insurance market to address perceived problems in the market, including low offer rates among smaller employers and the sometimes prohibitive cost of health plans available in the small group market. The credit is intended to help make small group coverage more affordable for certain small employers.

## Eligibility

The small business health insurance tax credit is generally available to qualifying non-profit and for-profit employers with fewer than 25 full-time equivalent (FTE) employees with average annual wages that fall under a statutorily-specified cap. In order to qualify for the credit, employers must cover at least 50% of the cost of each of their employees' self-only health insurance coverage.<sup>1</sup>

Beginning in 2014, the credit is generally available only to qualifying employers that purchase coverage through a Small Business Health Options Program (SHOP) exchange.<sup>2</sup> SHOP exchanges, as established under ACA, are marketplaces where private health insurance issuers sell health insurance plans to small employers.<sup>3</sup> All health plans available through SHOP exchanges must meet certain federally required criteria, such as offering a standardized package of benefits.<sup>4</sup>

As of 2014, the credit is available only for two consecutive tax years, beginning with the first year a qualified employer obtains coverage through a SHOP exchange.<sup>5</sup> In other words, if a qualified employer first obtains coverage through a SHOP exchange in 2016, the credit would only be available to the employer in 2016 and in 2017.

## Type of Credit

For non-profit (tax-exempt) employers,<sup>6</sup> the small business health insurance tax is in the form of a reduction in payroll taxes owed by the employer. Specifically, the credit reduces the income and

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<sup>1</sup> For purposes of determining premium payments paid by the employer, the IRS does not take into account employer contributions to health reimbursement arrangements (HRAs), health flexible spending accounts (FSAs), or health savings accounts (HSAs). Similarly, if an issuer varies premiums for tobacco users compared to non-users (as is allowed under ACA), any amount an employer pays in tobacco surcharges is not treated as premium payments.

<sup>2</sup> The Internal Revenue Service (IRS) provides transition relief for certain small employers that cannot obtain coverage offered through a SHOP exchange because the small employer's principal business address is in a county in which coverage through a SHOP is not available in 2014. The IRS has identified counties in Washington and Wisconsin to which this transition relief applies. Small employers located in the affected counties are able to obtain small business tax credits for coverage purchased outside a SHOP exchange in 2014. See IRS Notice 2014-6 for more details.

<sup>3</sup> In 2014 and 2015, the definition of a small employer for purposes of SHOP exchange eligibility is an employer with 100 or fewer employees or 50 or fewer employees (states may choose).

<sup>4</sup> For more information, see CRS Report R43771, *Small Business Health Options Program (SHOP) Exchange*, by Annie L. Mach and Joy M. Grossman.

<sup>5</sup> The credit first became available in 2010. From 2010 through 2013 the credit was available to qualifying employers that purchased coverage in the small group market outside of SHOP exchanges (as exchanges were not established until 2014). Receipt of the credit for any or all years between 2010 and 2013 does not disqualify an employer from receiving the credit in 2014 and in subsequent years.

<sup>6</sup> For purposes of this provision, a tax-exempt employer is "one that is exempt from federal income tax under section

Medicare tax the employer is required to withhold from employees' wages and the employer share of Medicare tax on employees' wages. The credit is thus limited by these amounts. In other words, the credit amount claimed by a non-profit employer cannot exceed the total amount of the employer's payroll taxes for the calendar year.

With respect to for-profit employers, the credit is in the form of a general business credit.<sup>7</sup> A general business credit is not refundable, but is limited by the for-profit employer's actual tax liability. In other words, if a for-profit company had a year in which it ended up paying no taxes (i.e., it had no taxable income, after accounting for all its other deductions and credits), then the small business tax credit could not be used for that year; there would be no income tax for this credit to reduce. However, as a general business credit, an unused credit amount can generally be carried back for one year and carried forward up to 20 years.<sup>8</sup> In other words, a qualified for-profit employer may generally claim the credit in a tax year in which the employer did not receive the credit.

## Credit Amount

Not all employers that qualify for a small business health insurance tax credit receive the full credit amount. Employers can claim the *full* credit amount if they meet the following two criteria:

- **The employer has 10 or fewer FTEs.** FTEs are calculated by dividing the total hours worked by all *employees* (see description below) during the tax year by 2,080 (with a maximum of 2,080 hours for any one employee).
- **The employer's average taxable wages are \$25,400 or less in 2014 (adjusted for inflation in subsequent years).**<sup>9</sup> This is calculated by dividing the aggregate amount of wages paid to the *employees* during the year by the number of FTEs (and then rounding to the nearest \$1,000).

For calculating the number of FTEs and their wages, the term *employee* includes all individuals who are considered employees under the common law standard,<sup>10</sup> including those who do not work full-time. However, the term excludes seasonal workers (persons working no more than 120 days during the year). In addition, the term excludes the following (as defined in the Internal Revenue Code): a self-employed individual, a 2% shareholder in an S-corporation, a 5% owner of an eligible small business, or someone who is a relation or dependent of these people.

## Full Credit

Beginning in 2014, the maximum credit is 50% of a for-profit employer's contribution toward premiums, and 35% of a non-profit employer's contributions toward premiums.<sup>11</sup> As of 2014, the

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501(a) [of the IRC] as an organization described in section 501(c) [of the IRC].” 26 C.F.R. §1.45R-1(a)(20).

<sup>7</sup> A general business credit reduces an employer's tax liability, or the amount of tax an employer owes.

<sup>8</sup> For 2010 only, the credit could not be carried back one year because it was first available for tax years after December 31, 2009. Beginning in 2011 and thereafter, it can be carried back one year, as part of the general business credit.

<sup>9</sup> The average taxable wages were \$25,000 or less for each year, 2010 through 2013. Statute requires the \$25,000 to be adjusted for inflation using the Consumer Price Index - Urban (CPI-U) beginning in 2014. The \$25,400 cited here is for 2014; the amount will likely increase in subsequent years.

<sup>10</sup> Common law employees are defined in 26 U.S.C. §31.3121(d)-1(c).

<sup>11</sup> In each of the four years 2010 through 2013, the full credit covered up to 35% of a qualified for-profit employer's contributions and 25% of a non-profit employer's contributions.

credit is only available to an employer for two consecutive tax years, generally beginning with the first year the employer offers coverage through a SHOP exchange. The employer contribution for purposes of determining the credit is calculated as the lesser of:

- the employer premium contribution toward coverage offered by the employer through a SHOP exchange; or
- the contribution the employer would have made if each of those same employees had enrolled in a health plan with a premium equal to the average (determined by the Secretary of Health and Human Services) for the small group market in the rating area in which the employee enrolls for coverage.<sup>12</sup>

Consider a for-profit employer that is qualified to receive a full credit in 2014. If the employer paid for 60% of premiums, the maximum small business tax credit in 2014 is equivalent to 50% of the employer contribution (or 30% of the total premium in this example—i.e., 50% of 60%). In this case, assuming the average total premium for this employer for each employee was \$7,500 (and that amount does not exceed the average premium for the small group market in each employee's rating area), and the employer's contribution was \$4,500 per full-time equivalent employee (FTE), the maximum tax credit would be \$2,250 per FTE (50% of \$4,500).<sup>13</sup>

In statute, the maximum credit for non-profit employers beginning in 2014 is 35%; however, the budget sequester has led to a reduction in the amount of the refundable portion of the credit for non-profit employers.<sup>14</sup> Refund payments processed on or after October 1, 2013, and on or before September 30, 2014, are decreased by the FY2014 sequestration rate of 7.2% over this time period. Refund payments processed on or before October 1, 2014, and on or before September 30, 2015, are decreased by the FY2015 sequestration rate of 7.3%.

Using the above example for a non-profit employer, without the budget sequester the maximum tax credit would have been \$1,575 per FTE (35% of \$4,500) in 2014. However, with the budget sequester, the maximum credit is reduced by about \$113 (7.2% of \$1,575) for each of the nine months in which the 2014 sequestration rate applies and by about \$115 (7.3% of \$1,575) for each of the three months in which the 2015 sequestration rate applies.

## Partial Credit: Phase-Out

In general, the credit is phased out as the number of FTEs increases from 10 to 25 and as average employee compensation increases. In 2014, the credit is phased out as average employee compensation increases from \$25,400 to \$50,800.<sup>15</sup>

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<sup>12</sup> Under ACA, a rating area is one of the four factors by which issuers are allowed to vary premiums for coverage purchased in the nongroup and small group markets. For more information about each state's rating areas, see <http://www.cms.gov/CCIIO/Programs-and-Initiatives/Health-Insurance-Market-Reforms/state-gra.html>.

<sup>13</sup> An employer can claim a regular business deduction for the amount of the employer contribution *not* covered by the credit (i.e., the amount of the contribution minus the dollar amount of the credit).

<sup>14</sup> The Budget Control Act of 2011 (BCA) established new budget enforcement mechanisms for reducing the federal deficit over the 10-year period, FY2012-FY2021. Under the BCA, the reductions will be achieved by a combination of sequestration (i.e., an automatic across-the-board cancellation of budgetary resources) and, beginning in FY2014, by lowering the discretionary spending caps. For more information about how sequestrations affects the small business health care tax credits, see IRS, "Small Business Health Care Tax Credit Questions and Answers: Calculating the Credit," available at <http://www.irs.gov/uac/Small-Business-Health-Care-Tax-Credit-Questions-and-Answers:-Calculating-the-Credit>.

<sup>15</sup> These dollar amounts were \$25,000 and \$50,000 for 2010 through 2013. Statute requires the amounts to be adjusted for inflation using the Consumer Price Index - Urban (CPI-U) beginning in 2014. The \$25,400 and \$50,800 cited here

**Table 1** shows the amount of the tax credit as a percentage (maximum of 32.5%) of a *non-profit* employer's contribution toward workers' health insurance in 2014, based on firm size and average wages. For example, the maximum credit in 2014 for a non-profit firm with 12 FTE employees and \$40,000 in average wages is 9.5%. The percentages in **Table 1** account for the impact of the budget sequester for all of 2014.<sup>16</sup>

**Table 2** shows the amount of the tax credit as a percentage (maximum of 50%) of a *for-profit* employer's contribution toward workers' health insurance for in 2014, based on firm size and average wages. For instance, a for-profit firm with 14 FTE employees and \$30,000 in average wages can receive a maximum credit of 27.6% in 2014.

**Table 1. Small Business Tax Credit as a Percentage of Employer Contribution to Premiums, Non-Profit Employers in 2014**

Firm size (number of full-time equivalent employees)	Average wage					
	\$25,400 and less	\$30,000	\$35,000	\$40,000	\$45,000	\$50,800
10 and fewer	32.5%	26.6%	20.2%	13.8%	7.4%	0.0%
11	30.3%	24.4%	18.0%	11.7%	5.3%	0.0%
12	28.2%	22.3%	15.9%	9.5%	3.1%	0.0%
13	26.0%	20.1%	13.7%	7.3%	0.9%	0.0%
14	23.8%	17.9%	11.5%	5.2%	0.0%	0.0%
15	21.7%	15.8%	9.4%	3.0%	0.0%	0.0%
16	19.5%	13.6%	7.2%	0.8%	0.0%	0.0%
17	17.3%	11.4%	5.0%	0.0%	0.0%	0.0%
18	15.2%	9.3%	2.9%	0.0%	0.0%	0.0%
19	13.0%	7.1%	0.7%	0.0%	0.0%	0.0%
20	10.8%	4.9%	0.0%	0.0%	0.0%	0.0%
21	8.7%	2.8%	0.0%	0.0%	0.0%	0.0%
22	6.5%	0.6%	0.0%	0.0%	0.0%	0.0%
23	4.3%	0.0%	0.0%	0.0%	0.0%	0.0%
24	2.2%	0.0%	0.0%	0.0%	0.0%	0.0%
25	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

**Source:** CRS calculations based on ACA and budget sequester rates.

**Note:** The maximum credit for non-profit employers in 2014 is 32.5%.

are for 2014; the amounts will likely increase in subsequent years.

<sup>16</sup> The new maximum percentage is calculated by including the 2014 and 2015 budget sequester rates in the formula as follows:

$$[(0.35)(1-0.072)(9)) + ((0.35)(1-0.73)(3))]/12 = 32.5\%$$

**Table 2. Small Business Tax Credit as a Percentage of Employer Contribution to Premiums, For-Profit Employers in 2014**

Firm size (number of full- time equivalent employees)	Average wage					
	\$25,400 and less	\$30,000	\$35,000	\$40,000	\$45,000	\$50,800
<b>10 and fewer</b>	50.0%	40.9%	31.1%	21.3%	11.4%	0.0%
<b>11</b>	46.7%	37.6%	27.8%	17.9%	8.1%	0.0%
<b>12</b>	43.3%	34.3%	24.4%	14.6%	4.8%	0.0%
<b>13</b>	40.0%	30.9%	21.1%	11.3%	1.4%	0.0%
<b>14</b>	36.7%	27.6%	17.8%	7.9%	0.0%	0.0%
<b>15</b>	33.3%	24.3%	14.4%	4.6%	0.0%	0.0%
<b>16</b>	30.0%	20.9%	11.1%	1.3%	0.0%	0.0%
<b>17</b>	26.7%	17.6%	7.8%	0.0%	0.0%	0.0%
<b>18</b>	23.3%	14.3%	4.4%	0.0%	0.0%	0.0%
<b>19</b>	20.0%	10.9%	1.1%	0.0%	0.0%	0.0%
<b>20</b>	16.7%	7.6%	0.0%	0.0%	0.0%	0.0%
<b>21</b>	13.3%	4.3%	0.0%	0.0%	0.0%	0.0%
<b>22</b>	10.0%	0.9%	0.0%	0.0%	0.0%	0.0%
<b>23</b>	6.7%	0.0%	0.0%	0.0%	0.0%	0.0%
<b>24</b>	3.3%	0.0%	0.0%	0.0%	0.0%	0.0%
<b>25</b>	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

**Source:** CRS calculations based on ACA.

**Notes:** The maximum credit for for-profit employers is 50% in 2014.

## Utilization of the Credit

Selected estimates of the number of employers eligible for the credit in 2010 ranged from about 1.4 million to 4 million.<sup>17</sup> However, Government Accountability Office (GAO) analysis of IRS data found that only 170,300 small businesses claimed the credit in tax year 2010. Of the claimants, 83% were ineligible to receive the full credit, usually because they did not meet the average wage requirement. Additionally, 30% of employer credit claims were reduced because the credit cannot exceed state average premiums for small group plans.<sup>18</sup>

Many small employers do not offer health insurance coverage.<sup>19</sup> However, even among those that do offer coverage, the take-up rate for the credit was less than expected in 2010. GAO cites as likely contributors to the lower than expected levels of participation the complexity for employers to determine their eligibility and calculate their credit amount, the need for employers to collect employee data that may not be readily available, and the fact that the credit is available for a maximum of six years.<sup>20</sup>

The number of businesses that have claimed the credit has not drastically increased in recent years. According to data from the IRS, at least 174,561 businesses claimed the credit in calendar year 2011, and at least 186,905 businesses claimed the credit in calendar year 2012.<sup>21</sup>

## Additional Information

The IRS is responsible for implementing the small business health insurance tax credit and maintains a website that provides information about the credit: <http://www.irs.gov/uac/Small-Business-Health-Care-Tax-Credit-for-Small-Employers>.

## Author Information

Annie L. Mach  
Analyst in Health Care Financing

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<sup>17</sup> GAO-12-549, "Small Employer Health Tax Credit," available at <http://www.gao.gov/assets/600/590832.pdf>.

<sup>18</sup> Ibid.

<sup>19</sup> According to data from the 2013 Medical Expenditure Panel Survey – Insurance Component (MEPS-IC), 34.8% of private-sector firms with fewer than 50 employees offered health insurance, while 95.7% of firms with 50 or more employees offered coverage in 2013.

<sup>20</sup> Ibid.

<sup>21</sup> The cited numbers were obtained from communication with the IRS. It should be noted that the process for claiming the credit changed in 2011. In 2010, every business, partner, and shareholder was required to claim their credit on Form 8941, Credit for Small Employer Health Insurance Premiums. Beginning in tax year 2011, partners and shareholders were no longer required to file a Form 8941 and could instead claim their share of the credit on Form 3800, General Business Credit Form. The number of businesses claiming credits cited here is based only on Form 8941 filings in 2011 and 2012. As such, the numbers may underestimate the number of businesses that claimed the credit in 2011 and 2012.

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